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**Financials**

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ALLIED CAPITAL CORP filed this on 08/14/2002.

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## FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

QUARTERLY REPORT PURSUANT TO  
SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period  
Ended June 30, 2002

Commission File Number:  
0-22832

### ALLIED CAPITAL CORPORATION

*(Exact Name of Registrant as Specified in its Charter)*

Maryland  
*(State or Jurisdiction of  
Incorporation or Organization)*

52-1081052  
*(IRS Employer  
Identification No.)*

1919 Pennsylvania Avenue, N.W.  
Washington, DC 20006  
*(Address of Principal Executive Offices)*

Registrant's telephone number, including area code: (202) 331-1112

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 12 of 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods as the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

On August 13, 2002 there were 102,306,364 shares outstanding of the Registrant's common stock, \$0.0001 par value.

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**ALLIED CAPITAL CORPORATION**
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**PART I: FINANCIAL INFORMATION**
**Item 1. Financial Statements**
**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEET**

	June 30, 2002	December 31, 2001
(in thousands, except share and per share amounts)	(unaudited)	
<b>ASSETS</b>		
Portfolio at value:		
Private finance		
Companies more than 25% owned (cost: 2002-\$512,468; 2001-\$451,705)	\$ 632,560	\$ 505,620
Companies 5% to 25% owned (cost: 2002-\$235,879; 2001-\$211,030)	264,691	232,399
Companies less than 5% owned (cost: 2002-\$832,665; 2001-\$891,231)	738,008	857,053
Total private finance	1,635,259	1,595,072
Commercial real estate finance (cost: 2002-\$724,240; 2001-\$732,636)	745,710	734,518
Total portfolio at value	2,380,969	2,329,590
Other assets	183,328	130,234
Cash and cash equivalents	4,319	889
Total assets	<u>\$2,568,616</u>	<u>\$2,460,713</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Notes payable and debentures	\$ 869,200	\$ 876,056
Revolving credit facility	139,750	144,750
Accounts payable and other liabilities	118,213	80,784
Total liabilities	1,127,163	1,101,590
Commitments and Contingencies		
Preferred stock	7,000	7,000
Shareholders' equity:		
Common stock, \$0.0001 par value, 200,000,000 shares authorized; 102,296,392 and 99,607,396 shares issued and outstanding at June 30, 2002 and December 31, 2001, respectively	10	10
Additional paid-in capital	1,417,356	1,352,688
Notes receivable from sale of common stock	(28,190)	(26,028)
Net unrealized appreciation on portfolio	64,118	39,981
Distributions in excess of earnings	(18,841)	(14,528)
Total shareholders' equity	1,434,453	1,352,123
Total liabilities and shareholders' equity	<u>\$2,568,616</u>	<u>\$2,460,713</u>
Net asset value per common share	<u>\$ 14.02</u>	<u>\$ 13.57</u>

The accompanying notes are an integral part of these consolidated financial statements.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share amounts)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2002	2001	2002	2001
	(unaudited)		(unaudited)	
Interest and related portfolio income:				
Interest and dividends				
Companies more than 25% owned	\$ 9,342	\$ 5,280	\$ 18,806	\$ 10,888
Companies 5% to 25% owned	7,305	6,680	14,385	12,911
Companies less than 5% owned	46,045	46,864	94,474	89,900
Total interest and dividends	62,692	58,824	127,665	113,699
Premiums from loan dispositions				
Companies more than 25% owned	—	—	—	511
Companies less than 5% owned	46	910	1,659	1,220
Total premiums from loan dispositions	46	910	1,659	1,731
Fees and other income				
Companies more than 25% owned	6,890	4,284	13,865	8,113
Companies 5% to 25% owned	476	150	476	150
Companies less than 5% owned	3,089	4,571	11,919	10,117
Total fees and other income	10,455	9,005	26,260	18,380
Total interest and related portfolio income	73,193	68,739	155,584	133,810
Expenses:				
Interest	17,515	15,951	34,984	31,881
Employee	8,274	7,610	16,309	14,056
Administrative	4,843	3,060	7,861	6,027
Total operating expenses	30,632	26,621	59,154	51,964
Net investment income before net realized and unrealized gains	42,561	42,118	96,430	81,846
Net realized and unrealized gains (losses):				
Net realized gains (losses)				
Companies more than 25% owned	(630)	(731)	(630)	(731)
Companies 5% to 25% owned	—	4,571	718	4,571
Companies less than 5% owned	(125)	(3)	8,762	1,151
Total net realized gains (losses)	(755)	3,837	8,850	4,991
Net unrealized gains	31,648	151	24,135	11,297
Total net realized and unrealized gains	30,893	3,988	32,985	16,288
Net increase in net assets resulting from operations	\$ 73,454	\$46,106	\$129,415	\$ 98,134
Basic earnings per common share	\$ 0.72	\$ 0.52	\$ 1.28	\$ 1.12
Diluted earnings per common share	\$ 0.71	\$ 0.51	\$ 1.26	\$ 1.10
Weighted average common shares outstanding — basic	101,660	89,356	100,822	87,441
Weighted average common shares outstanding — diluted	103,440	90,848	102,900	88,966

The accompanying notes are an integral part of these consolidated financial statements.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS**

	For the Six Months Ended June 30,	
	2002	2001
(in thousands, except per share amounts)		
	(unaudited)	
Operations:		
Net investment income before net realized and unrealized gains	\$ 96,430	\$ 81,846
Net realized gains	8,850	4,991
Net unrealized gains	24,135	11,297
Net increase in net assets resulting from operations	129,415	98,134
Shareholder distributions:		
Common stock dividends	(109,482)	(87,836)
Preferred stock dividends	(110)	(110)
Net decrease in net assets resulting from shareholder distributions	(109,592)	(87,946)
Capital share transactions:		
Sale of common stock	49,920	123,262
Issuance of common stock upon the exercise of stock options	11,626	6,258
Issuance of common stock in lieu of cash distributions	3,123	3,415
Net increase in notes receivable from sale of common stock	(2,162)	(1,154)
Net increase in net assets resulting from capital share transactions	62,507	131,781
Total increase in net assets	\$ 82,330	\$ 141,969
Net assets at beginning of period	\$1,352,123	\$1,029,692
Net assets at end of period	\$1,434,453	\$1,171,661
Net asset value per common share	\$ 14.02	\$ 12.79
Common shares outstanding at end of period	102,296	91,578

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**

(in thousands)	For the Six Months Ended June 30,	
	2002	2001
	(unaudited)	
Cash flows from operating activities:		
Net increase in net assets resulting from operations	\$ 129,415	\$ 98,134
Adjustments		
Portfolio investments	(195,455)	(299,843)
Repayments of investment principal	67,017	42,544
Proceeds from investment sales	126,280	74,648
Change in accrued or reinvested interest and dividends	(19,463)	(25,493)
Changes in other assets and liabilities	(18,982)	(7,374)
Amortization of loan discounts and fees	(9,284)	(7,722)
Depreciation and amortization	657	479
Realized losses	6,579	1,605
Net unrealized gains	(24,135)	(11,297)
Net cash provided by (used in) operating activities	62,629	(134,319)
Cash flows from financing activities:		
Sale of common stock	49,920	123,262
Sale of common stock upon the exercise of stock options	9,245	2,103
Collections of notes receivable from sale of common stock	220	3,002
Common dividends and distributions paid	(106,359)	(84,422)
Preferred stock dividends paid	(110)	(110)
Net borrowings under (repayments on) notes payable and debentures	(6,856)	11,666
Net borrowings under (repayments on) revolving line of credit	(5,000)	82,750
Other	(259)	(2,948)
Net cash provided by (used in) financing activities	(59,199)	135,303
Net increase in cash and cash equivalents	\$ 3,430	\$ 984
Cash and cash equivalents at beginning of period	\$ 889	\$ 2,449
Cash and cash equivalents at end of period	\$ 4,319	\$ 3,433

The accompanying notes are an integral part of these consolidated financial statements.

**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF INVESTMENTS**

		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited) Cost                  Value	
<b>Companies More Than 25% Owned</b>			
Acme Paging, L.P. (Telecommunications)	Loan	\$ 3,200	\$ 3,200
	Debt Securities	7,005	7,005
	Equity Interests	3,717	2,261
American Healthcare Services, Inc. (Healthcare)	Debt Securities	41,362	41,362
	Common Stock (79,567,042 shares)	1,000	100
	Guaranty (\$915)	—	—
Business Loan Express, Inc. (Financial Services)	Loan	6,000	6,000
	Debt Securities	80,809	80,809
	Preferred Stock (25,111 shares)	25,111	25,111
	Common Stock (25,503,043 shares)	104,641	140,000
	Guaranty (\$48,126 — See Note 3)	—	—
	Standby Letters of Credit (\$10,550 — See Note 3)	—	—
The Color Factory Inc. (Consumer Products)	Loan	7,439	7,439
	Preferred Stock (1,000 shares)	1,002	1,002
	Common Stock (980 shares)	6,535	8,035
Directory Investment Corporation (Publishing)	Common Stock (470 shares)	112	32
Directory Lending Corporation (Publishing)	Series A Common Stock (34 shares)	—	—
	Series B Common Stock (6 shares)	8	—
	Series C Common Stock (10 shares)	22	—
EDM Consulting, LLC (Business Services)	Debt Securities	1,875	443
	Equity Interests	250	—
Elmhurst Consulting, LLC (Business Services)	Loan	12,530	12,530
	Equity Interests	5,165	5,165
	Guaranty (\$2,190)	—	—
Foresite Towers, LLC (Tower Leasing)	Equity Interests	15,522	15,522
Gordian Group, Inc. (Business Services)	Loan	6,965	6,965
	Common Stock (1,000 shares)	1,300	1,300
HealthASPex, Inc. (Business Services)	Preferred Stock (1,451,380 shares)	4,900	2,617
	Preferred Stock (700,000 shares)	700	700
	Common Stock (1,451,380 shares)	4	—
The Hillman Companies Inc.(1) (Consumer Products)	Debt Securities	41,012	41,012
	Common Stock (6,890,937 shares)	57,156	90,000

(1) Public company.

(2) Common stock, preferred stock, warrants, options and equity interests are generally nonincome producing and restricted.

(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.



		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited)	
		Cost	Value
xHMT, Inc. (Business Services)	Debt Securities	\$ 9,036	\$ 9,036
	Preferred Stock (519,484 shares)	2,078	2,078
	Common Stock (300,000 shares)	3,000	1,694
	Warrants	1,155	651
Monitoring Solutions, Inc. (Business Services)	Debt Securities	1,823	153
	Common Stock (33,333 shares)	—	—
	Warrants	—	—
MVL Group, Inc. (Business Services)	Loan	16,963	16,963
	Debt Securities	16,116	16,116
	Common Stock (650,000 shares)	643	643
Spa Lending Corporation (Recreation)	Preferred Stock (28,625 shares)	409	288
	Common Stock (6,208 shares)	—	—
STS Operating, Inc. (Industrial Products)	Common Stock (3,000,000 shares)	3,177	3,177
Sure-Tel, Inc. (Consumer Services)	Preferred Stock (1,000,000 shares)	1,000	1,000
	Common Stock (37,000 shares)	5,018	5,018
Total Foam, Inc. (Industrial Products)	Debt Securities	260	125
	Common Stock (910 shares)	10	—
WyoTech Acquisition Corporation (Education)	Debt Securities	12,638	12,638
	Preferred Stock (100 shares)	3,700	3,700
	Common Stock (99 shares)	100	60,670
<b>Total companies more than 25% owned</b>		<b>\$512,468</b>	<b>\$632,560</b>
<b>Companies 5% to 25% Owned</b>			
Aspen Pet Products, Inc. (Consumer Products)	Loans	\$ 15,111	\$ 15,111
	Preferred Stock (2,021 shares)	1,981	1,981
	Common Stock (1,400 shares)	140	140
Autania AG(1,3) (Industrial Products)	Debt Securities	4,487	4,487
	Common Stock (250,000 shares)	2,169	2,169
CBA-Mezzanine Capital Finance, LLC (Financial Services)	Loan	313	313
Colibri Holding Corporation (Consumer Products)	Loans	3,478	3,478
	Preferred Stock (237 shares)	248	248
	Common Stock (3,362 shares)	1,250	1,250
	Warrants	290	290
CorrFlex Graphics, LLC (Business Services)	Debt Securities	2,393	2,393
	Warrants	—	17,490
	Options	—	1,510
Csabai Canning Factory Rt(3) (Consumer Products)	Hungarian Quotas (9.2%)	700	—

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		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited)	
		Cost	Value
CyberRep (Business Services)	Loan	\$ 1,184	\$ 1,184
	Debt Securities	14,550	14,550
	Warrants	660	3,310
The Debt Exchange Inc. (Business Services)	Preferred Stock (921,829 shares)	1,250	1,250
Gibson Guitar Corporation (Consumer Products)	Debt Securities	17,558	17,558
	Warrants	525	2,325
International Fiber Corporation (Industrial Products)	Debt Securities	22,499	22,499
	Common Stock (1,029,068 shares)	5,483	6,982
	Warrants	550	700
Liberty-Pittsburgh Systems, Inc. (Business Services)	Debt Securities	3,494	3,494
	Common Stock (123,929 shares)	142	142
Litterer Beteiligungs-GmbH(3) (Business Services)	Debt Securities	1,070	1,070
	Equity Interest	358	358
Logic Bay Corporation (Business Services)	Preferred Stock (1,131,222 shares)	5,000	1,000
Magna Card, Inc. (Consumer Products)	Debt Securities	153	153
	Preferred Stock (1,875 shares)	94	94
	Common Stock (4,687 shares)	—	—
Master Plan, Inc. (Business Services)	Loan	1,204	1,204
	Common Stock (156 shares)	42	42
MortgageRamp.com, Inc. (Business Services)	Common Stock (772,000 shares)	3,860	3,860
Morton Grove Pharmaceuticals, Inc. (Consumer Products)	Loan	16,356	16,356
	Preferred Stock (106,947 shares)	5,000	12,000
Nobel Learning Communities, Inc.(1) (Education)	Debt Securities	9,704	9,704
	Preferred Stock (1,063,830 shares)	2,000	2,000
	Warrants	575	296
North American Archery, LLC (Consumer Products)	Loans	1,390	840
	Convertible Debentures	2,248	59
	Guaranty (\$1,020)	—	—
Packaging Advantage Corporation (Business Services)	Debt Securities	11,635	11,635
	Common Stock (200,000 shares)	2,000	2,000
	Warrants	963	963
Professional Paint, Inc. (Consumer Products)	Debt Securities	22,086	22,086
	Preferred Stock (15,000 shares)	18,309	18,309
	Common Stock (110,000 shares)	69	4,500

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		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited)	
		Cost	Value
Progressive International Corporation (Consumer Products)	Debt Securities Preferred Stock (500 shares) Common Stock (197 shares) Warrants	\$ 3,963 500 13 —	\$ 3,963 500 13 —
Redox Brands, Inc. (Consumer Products)	Debt Securities Preferred Stock (2,404,086 shares) Warrants	9,649 6,974 584	9,649 6,974 584
Staffing Partners Holding Company, Inc. (Business Services)	Loan Debt Securities Preferred Stock (414,600 shares) Common Stock (50,200 shares) Warrants	2,500 4,992 2,073 50 10	2,500 4,992 2,073 50 10
<b>Total companies 5% to 25% owned</b>		<b>\$235,879</b>	<b>\$264,691</b>
<b>Companies Less Than 5% Owned</b>			
ACE Products, Inc. (Industrial Products)	Loans	\$ 17,164	\$ 15,839
Advantage Mayer, Inc. (Business Services)	Debt Securities Warrants	10,654 382	10,654 1,455
Alderwoods Group, Inc.(1) (Consumer Services)	Common Stock (357,568 shares)	5,006	2,739
Allied Office Products, Inc. (Business Services)	Debt Securities Warrants	7,628 629	50 —
American Barbecue & Grill, Inc. (Retail)	Warrants	125	—
American Home Care Supply, LLC (Consumer Products)	Debt Securities Warrants	6,935 579	6,935 1,579
ASW Holding Corporation (Industrial Products)	Warrants	25	25
Avborne, Inc. (Business Services)	Debt Securities Warrants	12,959 1,180	3,500 —
Bakery Chef, Inc. (Consumer Products)	Loans	17,604	17,604
Blue Rhino Corporation(1) (Consumer Products)	Debt Securities Warrants	13,913 1,200	13,913 13,500
Border Foods, Inc.	Debt Securities	9,347	9,347

(Consumer Products)	Preferred Stock (50,919 shares)	2,000	2,000
	Warrants	665	665
Camden Partners Strategic Fund II, L.P. (4) (Private Equity Fund)	Limited Partnership Interest	1,879	2,002

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		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited)	
		Cost	Value
Candlewood Hotel Company(1) (Hospitality)	Preferred Stock (3,250 shares)	\$ 3,250	\$ 1,300
Celebrities, Inc. (Broadcasting & Cable)	Loan	230	230
	Warrants	12	492
Component Hardware Group, Inc. (Industrial Products)	Debt Securities	11,032	11,032
	Preferred Stock (18,000 shares)	1,800	1,800
	Common Stock (2,000 shares)	200	200
Convenience Corporation of America (Retail)	Debt Securities	8,355	2,738
	Preferred Stock (22,301 shares)	334	—
	Warrants	—	—
Cooper Natural Resources, Inc. (Industrial Products)	Loan	299	299
	Debt Securities	1,815	1,815
	Preferred Stock (6,316 shares)	1,427	1,427
	Warrants	832	832
Coverall North America, Inc. (Business Services)	Loan	10,418	10,418
	Debt Securities	5,740	5,740
CPM Acquisition Corporation (Industrial Products)	Loan	9,902	9,902
CTT Holdings (Consumer Products)	Loan	1,478	1,478
Cumulus Media, Inc. (1) (Broadcasting & Cable)	Common Stock (11,037 shares)	198	152
Drilltec Patents & Technologies Company, Inc. (Industrial Products)	Loan	10,918	348
	Debt Securities	1,500	1,500
	Warrants	—	—
eCentury Capital Partners, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	1,875	1,691
El Dorado Communications, Inc. (Broadcasting & Cable)	Loans	306	306
Elaxis Beta GmbH(3) (Industrial Products)	Options	426	426

Epartin S.A.(3) (Consumer Products)	Loan	29	29
E-Talk Corporation (Business Services)	Debt Securities	8,852	1,000
	Warrants	1,157	—
Executive Greetings, Inc. (Business Services)	Debt Securities	17,327	17,327
	Warrants	360	360
ExTerra Credit Recovery, Inc. (Business Services)	Preferred Stock (500 shares)	568	103
	Common Stock (2,500 shares)	—	—
	Warrants	—	—

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		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited)	
		Cost	Value
Fairchild Industrial Products Company (Industrial Products)	Debt Securities	\$ 5,906	\$ 5,906
	Warrants	280	1,100
Galaxy American Communications, LLC (Broadcasting & Cable)	Debt Securities	48,433	34,010
	Options	—	—
	Standby Letter of Credit (\$750)	—	—
Garden Ridge Corporation (Retail)	Debt Securities	27,070	27,070
	Preferred Stock (1,130 shares)	1,130	1,130
	Common Stock (188,400 shares)	613	613
GC-Sun Holdings II, LP (Kar Products, LP) (Business Services)	Loans	8,167	8,167
Ginsey Industries, Inc. (Consumer Products)	Loans	5,000	5,000
	Convertible Debentures	500	500
	Warrants	—	1,500
Global Communications, LLC (Business Services)	Loan	1,997	1,997
	Debt Securities	15,262	15,262
	Equity Interest	11,067	11,067
	Options	1,639	1,639
Grant Broadcasting Systems II (Broadcasting & Cable)	Warrants	87	3,000
Grotech Partners, VI, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	1,832	1,398
The Hartz Mountain Corporation (Consumer Products)	Debt Securities	27,544	27,544
	Common Stock (200,000 shares)	2,000	2,000
	Warrants	2,613	2,613
Hotelevision, Inc. (Broadcasting & Cable)	Preferred Stock (315,100 shares)	315	315

Icon International, Inc. (Business Services)	Common Stock (35,228 shares)	1,219	2,712
Impact Innovations Group, LLC (Business Services)	Debt Securities	6,727	3,436
	Warrants	1,674	—
Intellirisk Management Corporation (Business Services)	Loans	22,796	22,796
Interline Brands, Inc. (Business Services)	Debt Securities	33,431	33,431
	Preferred Stock (199,313 shares)	1,849	1,849
	Common Stock (15,615 shares)	139	139
	Warrants	1,181	1,181
Jakel, Inc. (Industrial Products)	Loan	23,307	16,047

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		June 30, 2002	
(in thousands, except number of shares)	Private Finance Portfolio Company Investment(2)	(unaudited)	
		Cost	Value
JRI Industries, Inc. (Industrial Products)	Debt Securities	\$ 1,981	\$ 1,981
	Warrants	74	74
Julius Koch USA, Inc. (Industrial Products)	Debt Securities	453	453
	Warrants	259	8,000
Kirker Enterprises, Inc. (Industrial Products)	Warrants	348	3,501
	Equity Interest	4	4
Kirkland's, Inc. (Retail)	Debt Securities	6,387	6,387
	Preferred Stock (917 shares)	412	412
	Warrants	96	5,816
Kyrus Corporation (Business Services)	Debt Securities	7,380	7,380
	Warrants	348	348
Love Funding Corporation (Financial Services)	Preferred Stock (26,000 shares)	359	213
Matrics, Inc. (Business Services)	Preferred Stock (511,876 shares)	500	500
	Warrants	—	—
MedAssets.com, Inc. (Business Services)	Debt Securities	15,363	15,363
	Preferred Stock (260,417 shares)	2,049	2,049
	Warrants	136	136
Mid-Atlantic Venture Fund IV, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	2,475	1,479
Midview Associates, L.P. (Housing)	Warrants	—	—
Most Confiserie GmbH & Co KG(3) (Consumer Products)	Loan	950	50

(Consumer Products)			
NetCare, AG(3)	Loan	760	50
(Business Services)	Common Stock (262,784 shares)	230	—
NETtel Communications, Inc.	Debt Securities and Receivables	11,334	4,334
(Telecommunications)			
Northeast Broadcasting Group, L.P.	Debt Securities	289	289
(Broadcasting & Cable)			
Novak Biddle Venture Partners III, L.P.	Limited Partnership Interest		
(4)		420	420
(Private Equity Fund)			
Nursefinders, Inc.	Debt Securities	11,151	11,151
(Business Services)	Warrants	900	3,060
Onyx Television GmbH(3)	Preferred Units (120,000 shares)	201	8
(Broadcasting & Cable)			

(1) Public company.

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(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

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		June 30, 2002	
Private Finance Portfolio Company (in thousands, except number of shares)	Investment(2)	(unaudited)	
		Cost	Value
Opinion Research Corporation(1)	Debt Securities	\$14,269	\$14,269
(Business Services)	Warrants	996	881
Oriental Trading Company, Inc.	Debt Securities	12,920	12,920
(Consumer Products)	Preferred Equity Interest	1,500	1,500
	Common Equity Interest	—	2,000
	Warrants	13	2,300
Outsource Partners, Inc.	Debt Securities	24,048	24,048
(Business Services)	Warrants	826	826
Pico Products, Inc.	Loan	1,406	1,406
(Industrial Products)			
Polaris Pool Systems, Inc.	Debt Securities	10,630	10,630
(Consumer Products)	Warrants	1,145	1,145
Powell Plant Farms, Inc.	Loan	19,095	14,087
(Consumer Products)			
Proeducation GmbH(3)	Loan	321	321
(Education)			
Prosperco Finanz Holding AG(3)	Convertible Debentures	5,492	5,492
(Financial Services)	Common Stock (1,528 shares)	1,059	1,059
	Warrants	—	—
Raytheon Aerospace, LLC	Debt Securities	5,130	5,130
(Business Services)	Equity Interest	—	—
Schwinn Holdings Corporation	Debt Securities	10,195	1,835
(Consumer Products)			

(Consumer Products)			
Seasonal Expressions, Inc. (Consumer Products)	Preferred Stock (504 shares)	500	—
Simula, Inc.(1) (Industrial Products)	Loan	20,539	20,539
Soff-Cut Holdings, Inc. (Industrial Products)	Debt Securities	8,807	8,807
	Preferred Stock (300 shares)	300	300
	Common Stock (2,000 shares)	200	200
Southwest PCS, LLC (Telecommunications)	Loan	6,059	6,059
Startec Global Communications Corporation(1) (Telecommunications)	Loan	23,815	23,815
	Debt Securities	21,432	245
	Common Stock (258,064 shares)	3,000	—
	Warrants	—	—
SunStates Refrigerated Services, Inc. (Warehouse Facilities)	Loans	6,062	4,188
	Debt Securities	2,445	—

(1) Public company.

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(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

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Private Finance Portfolio Company (in thousands, except number of shares)		June 30, 2002	
		(unaudited)	
	Investment(2)	Cost	Value
Sydran Food Services II, L.P. (Retail)	Debt Securities	\$ 12,973	\$ 12,973
	Equity Interests	3,909	3,909
	Warrants	—	—
Tubbs Snowshoe Company, LLC (Consumer Products)	Debt Securities	3,920	3,920
	Equity Interests	500	500
	Warrants	54	54
United Pet Group, Inc. (Consumer Products)	Debt Securities	8,987	8,987
	Warrants	85	85
Updata Venture Partners, II, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	2	1,492
Velocita, Inc. (Telecommunications)	Debt Securities	11,718	—
	Warrants	3,540	—
Venturehouse Group, LLC(4) (Private Equity Fund)	Equity Interest	667	380
Walker Investment Fund II, LLLP(4) (Private Equity Fund)	Limited Partnership Interest	1,200	943
Warn Industries, Inc. (Consumer Products)	Debt Securities	11,513	11,513
	Warrants	1,429	3,129
Williams Brothers Lumber Company	Warrants	24	100



Company (Retail)			
Wilshire Restaurant Group, Inc. (Retail)	Debt Securities	15,630	15,630
	Warrants	735	735
Wilton Industries, Inc. (Consumer Products)	Loan	12,000	12,000
Woodstream Corporation (Consumer Products)	Loan	2,621	2,621
	Debt Securities	7,653	7,653
	Equity Interests	1,700	4,547
	Warrants	450	1,203
<b>Total companies less than 5% owned</b>		<b>\$ 832,665</b>	<b>\$ 738,008</b>
<b>Total private finance (133 portfolio companies)</b>		<b>\$1,581,012</b>	<b>\$1,635,259</b>

(1) Public company.

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(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

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(in thousands, except number of loans)	Stated Interest	Face	June 30, 2002 (unaudited)	
			Cost	Value
<b>Commercial Real Estate Finance</b>				
<b>Commercial Mortgage-Backed Securities</b>				
<b>CMBS Bonds</b>				
Mortgage Capital Funding, Series 1998-MC3	5.5%	\$ 54,491	\$ 27,330	\$ 27,344
Morgan Stanley Capital I, Series 1999-RM1	6.4%	51,046	21,553	21,395
COMM 1999-1	5.6%	74,879	36,316	36,409
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	37,752	16,811	16,804
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	83,210	36,674	36,783
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	34,856	16,301	16,340
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	29,005	11,576	12,188
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	37,430	16,579	17,426
FUNB CMT, Series 1999-C4	6.5%	43,372	18,259	18,865
Heller Financial, HFCMC Series 2000 PH-1	6.8%	45,456	18,516	19,319
SBMS VII, Inc., Series 2000-NL1	7.2%	20,804	10,764	11,309
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	38,685	18,345	19,030
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	39,379	17,523	18,722
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	34,967	12,617	14,000
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CK1	5.9%	43,288	18,139	19,741
JP Morgan-CIBC-Deutsche 2001	5.8%	46,326	19,788	20,430
Lehman Brothers-UBS Warburg 2001-C4	6.4%	49,582	21,989	24,069
SBMS VII, Inc., Series 2001-C1	6.1%	41,109	16,017	16,774
GE Capital Commercial Mortgage Securities Corp., Series 2001-2	6.1%	45,218	19,947	20,699
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CKN5	5.2%	59,602	28,245	29,518

JP Morgan Chase Commercial Mortgage Securities Corp., Series 2001-C1	5.6%	42,747	16,142	16,881
SBMS VII, Inc., Series 2001-C2	6.2%	47,353	22,043	24,180
FUNB CMT, Series 2002-C1	6.0%	38,238	16,592	17,630
GE Capital Commercial Mortgage Corp., Series 2002-1	6.2%	80,490	44,316	48,976
GMAC Commercial Mortgage Securities, Inc., Series 2002-C2	5.8%	62,704	34,643	36,058
<b>Total CMBS bonds</b>		<b>\$1,181,989</b>	<b>\$537,025</b>	<b>\$560,890</b>
<b>Collateralized Debt Obligations</b>				
Crest 2001-1, Ltd.(3)		24,023	24,023	24,023
Crest 2002-1, Ltd.(3)		23,541	23,541	23,541
Crest 2002-IG, Ltd.(3)		4,969	4,969	4,969
<b>Total collateralized debt obligations</b>		<b>\$ 52,533</b>	<b>\$ 52,533</b>	<b>\$ 52,533</b>
<b>Total CMBS</b>		<b>\$1,234,522</b>	<b>\$589,558</b>	<b>\$613,423</b>

	<b>Interest Rate Ranges</b>	<b>Number of Loans</b>	<b>Cost</b>	<b>Value</b>
<b>Commercial Mortgage Loans</b>				
	Up to 6.99%	9	\$ 8,108	\$ 9,122
	7.00%- 8.99%	19	21,252	20,555
	9.00%-10.99%	10	9,879	9,879
	11.00%-12.99%	10	14,746	14,540
	13.00%-14.99%	6	7,856	7,856
	15.00% and above	1	49	49
<b>Total commercial mortgage loans</b>		<b>55</b>	<b>\$ 61,890</b>	<b>\$ 62,001</b>
<b>Residual Interest</b>			<b>\$ 69,341</b>	<b>\$ 69,042</b>
<b>Real Estate Owned</b>			<b>3,451</b>	<b>1,244</b>
<b>Total commercial real estate finance</b>			<b>\$ 724,240</b>	<b>\$ 745,710</b>
<b>Total portfolio</b>			<b>\$2,305,252</b>	<b>\$2,380,969</b>

(3) Non-U.S. company.

The accompanying notes are an integral part of these consolidated financial statements.

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF INVESTMENTS

<b>Private Finance Portfolio Company</b>		<b>December 31, 2001</b>	
<b>(in thousands, except number of shares)</b>	<b>Investment(2)</b>	<b>Cost</b>	<b>Value</b>
<b>Companies More Than 25% Owned</b>			
Acme Paging, L.P. (Telecommunications)	Debt Securities	\$ 6,992	\$ 6,992
	Equity Interests	3,640	2,184
American Healthcare Services, Inc. (Healthcare)	Debt Securities	40,194	40,194
	Common Stock (79,567,042 shares)	1,000	100
	Guaranty (\$195)	—	—
Business Loan Express, Inc. (Financial Services)	Loan	6,000	6,000
	Debt Securities	76,242	76,242
	Preferred Stock (25,111 shares)	25,111	25,111

		2001	2000
	Common Stock (25,503,043 shares)	104,596	120,096
	Guaranty (\$51,350 — See Note 3)	—	—
The Color Factory Inc. (Consumer Products)	Loan	5,346	5,346
	Preferred Stock (600 shares)	788	788
	Common Stock (980 shares)	6,535	8,035
Directory Investment Corporation (Publishing)	Common Stock (470 shares)	112	32
Directory Lending Corporation (Publishing)	Series A Common Stock (34 shares)	—	—
	Series B Common Stock (6 shares)	8	—
	Series C Common Stock (10 shares)	22	—
EDM Consulting, LLC (Business Services)	Debt Securities	1,875	443
	Equity Interest	250	—
Elmhurst Consulting, LLC (Business Services)	Loan	7,762	7,762
	Equity Interests	5,157	5,157
	Guaranty (\$2,800)	—	—
Foresite Towers, LLC (Tower Leasing)	Equity Interests	15,500	15,500
HealthASPex, Inc. (Business Services)	Preferred Stock (1,451,380 shares)	4,900	3,900
	Preferred Stock (611,923 shares)	612	612
	Common Stock (1,451,380 shares)	4	—
The Hillman Companies, Inc. (Consumer Products)	Debt Securities	40,071	40,071
	Common Stock (6,890,937 shares)	57,156	57,156
HMT, Inc. (Business Services)	Debt Securities	8,995	8,995
	Common Stock (300,000 shares)	3,000	3,000
	Warrants	1,155	1,155
Monitoring Solutions, Inc. (Business Services)	Debt Securities	1,823	153
	Common Stock (33,333 shares)	—	—
	Warrants	—	—

(1) Public company.

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(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

Private Finance Portfolio Company (in thousands, except number of shares)		December 31, 2001	
	Investment(2)	Cost	Value
Spa Lending Corporation (Recreation)	Preferred Stock (28,625 shares)	\$ 485	\$ 375
	Common Stock (6,208 shares)	25	18
STS Operating, Inc. (Industrial Products)	Common Stock (3,000,000 shares)	3,177	3,177
Sure-Tel, Inc. (Consumer Services)	Loan	1,207	1,207
	Preferred Stock (1,116,902 shares)	4,642	4,642
	Warrants	662	662
	Options	—	—
Total Foam, Inc.	Debt Securities	263	127

(Industrial Products)	Common Stock (910 shares)	10	—
WyoTech Acquisition Corporation	Debt Securities	12,588	12,588
(Education)	Preferred Stock (100 shares)	3,700	3,700
	Common Stock (99 shares)	100	44,100
<b>Total companies more than 25% owned</b>		<b>\$451,705</b>	<b>\$505,620</b>
<b>Companies 5% to 25% Owned</b>			
Aspen Pet Products, Inc.	Loans	\$ 14,576	\$ 14,576
(Consumer Products)	Preferred Stock (1,860 shares)	1,981	1,981
	Common Stock (1,400 shares)	140	140
Autania AG(1,3)	Debt Securities	4,762	4,762
(Industrial Products)	Common Stock (250,000 shares)	2,261	2,261
Colibri Holding Corporation	Loans	3,464	3,464
(Consumer Products)	Preferred Stock (237 shares)	237	237
	Common Stock (3,362 shares)	1,250	1,250
	Warrants	290	290
CorrFlex Graphics, LLC	Debt Securities	2,312	2,312
(Business Services)	Warrants	—	6,674
	Options	—	576
Csabai Canning Factory Rt(3)	Hungarian Quotas (9.2%)	700	—
(Consumer Products)			
CyberRep	Loan	1,109	1,109
(Business Services)	Debt Securities	14,209	14,209
	Warrants	660	3,310
The Debt Exchange Inc.	Preferred Stock (921,829 shares)	1,250	1,250
(Business Services)			
FTI Consulting, Inc.(1)	Warrants	—	510
(Business Services)			
Gibson Guitar Corporation	Debt Securities	17,175	17,175
(Consumer Products)	Warrants	525	2,325

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<b>Private Finance Portfolio Company</b>		<b>December 31, 2001</b>	
<b>(in thousands, except number of shares)</b>	<b>Investment(2)</b>	<b>Cost</b>	<b>Value</b>
International Fiber Corporation	Debt Securities	\$ 22,257	\$ 22,257
(Industrial Products)	Common Stock (1,029,068 shares)	5,483	6,982
	Warrants	550	700
Liberty-Pittsburgh Systems, Inc.	Debt Securities	3,487	3,487
(Business Services)	Common Stock (123,929 shares)	142	142
Logic Bay Corporation	Preferred Stock (1,131,222 shares)	5,000	5,000
(Business Services)			
Magna Card, Inc.	Debt Securities	153	153

(Consumer Products)	Preferred Stock (1,875 shares)	94	94
	Common Stock (4,687 shares)	—	—
Master Plan, Inc.	Loan	1,204	1,204
(Business Services)	Common Stock (156 shares)	42	2,042
MortgageRamp.com, Inc.	Common Stock (772,000 shares)	3,860	3,860
(Business Services)			
Morton Grove	Loan	16,150	16,150
Pharmaceuticals, Inc.	Preferred Stock (106,947 shares)	5,000	9,000
(Consumer Products)			
Nobel Learning Communities, Inc.(1)	Debt Securities	9,656	9,656
(Education)	Preferred Stock (265,957 shares)	2,000	2,000
	Warrants	575	575
North American Archery, LLC	Loans	1,390	840
(Consumer Products)	Convertible Debentures	2,248	2,008
	Guaranty (\$270)	—	—
Packaging Advantage Corporation	Debt Securities	11,586	11,586
(Business Services)	Common Stock (200,000 shares)	2,000	2,000
	Warrants	963	963
Professional Paint, Inc.	Debt Securities	21,409	21,409
(Consumer Products)	Preferred Stock (15,000 shares)	17,215	17,215
	Common Stock (110,000 shares)	69	3,069
Progressive International Corporation	Debt Securities	3,958	3,958
(Consumer Products)	Preferred Stock (500 shares)	500	500
	Common Stock (197 shares)	13	13
	Warrants	—	—
Staffing Partners Holding Company, Inc.	Debt Securities	4,992	4,992
(Business Services)	Preferred Stock (414,600 shares)	2,073	2,073
	Common Stock (50,200 shares)	50	50
	Warrants	10	10
<b>Total companies 5% to 25% owned</b>		<b>\$211,030</b>	<b>\$232,399</b>

(1) Public company.

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(3) Non-U.S. company.

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Private Finance Portfolio Company		December 31, 2001	
(in thousands, except number of shares)	Investment(2)	Cost	Value
<b>Companies Less Than 5% Owned</b>			
Ability One Corporation	Loans	\$10,657	\$10,657
(Consumer Products)			
ACE Products, Inc.	Loans	16,875	16,875
(Industrial Products)			
Advantage Mayer, Inc.	Debt Securities	10,945	10,945
(Business Services)	Warrants	—	—

Allied Office Products, Inc. (Business Services)	Debt Securities	7,491	7,491
	Warrants	629	629
American Barbecue & Grill, Inc. (Retail)	Warrants	125	—
American Home Care Supply, LLC (Consumer Products)	Debt Securities	6,906	6,906
	Warrants	579	1,579
ASW Holding Corporation (Industrial Products)	Warrants	25	25
Aurora Communications, LLC (Broadcasting & Cable)	Loans	15,809	15,809
	Equity Interest	2,461	6,050
Avborne, Inc. (Business Services)	Debt Securities	12,750	6,375
	Warrants	1,180	—
Bakery Chef, Inc. (Consumer Products)	Loans	17,018	17,018
Blue Rhino Corporation(1) (Consumer Products)	Debt Securities	13,816	13,816
	Warrants	1,200	2,000
Border Foods, Inc. (Consumer Products)	Debt Securities	9,313	9,313
	Preferred Stock (50,919 shares)	2,000	2,000
	Warrants	665	665
Camden Partners Strategic Fund II, L.P. (4) (Private Equity Fund)	Limited Partnership Interest	1,295	1,295
CampGroup, LLC (Recreation)	Debt Securities	2,702	2,702
	Warrants	220	220
Candlewood Hotel Company(1) (Hospitality)	Preferred Stock (3,250 shares)	3,250	3,250
Celebrities, Inc. (Broadcasting & Cable)	Loan	244	244
	Warrants	12	550
Classic Vacation Group, Inc.(1) (Consumer Products)	Loan	6,399	6,399

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Private Finance Portfolio Company		December 31, 2001	
(in thousands, except number of shares)	Investment(2)	Cost	Value
Component Hardware Group, Inc. (Industrial Products)	Debt Securities	\$10,774	\$10,774
	Preferred Stock (18,000 shares)	1,800	1,800
	Common Stock (2,000 shares)	200	200
Convenience Corporation of America (Retail)	Debt Securities	8,355	2,738
	Preferred Stock (22,301 shares)	334	—
	Warrants	—	—
Cooper Natural Resources, Inc.	Debt Securities	1,750	1,750

(Industrial Products)	Preferred Stock (6,316 shares)	1,427	1,427
	Warrants	832	832
Coverall North America, Inc. (Business Services)	Loan	10,309	10,309
	Debt Securities	5,324	5,324
	Warrants	—	—
CPM Acquisition Corporation (Industrial Products)	Loan	9,604	9,604
CTT Holdings (Consumer Products)	Loan	1,388	1,388
Drilltec Patents & Technologies Company, Inc. (Industrial Products)	Loan	10,918	9,262
	Debt Securities	1,500	1,500
	Warrants	—	—
eCentury Capital Partners, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	1,875	1,800
El Dorado Communications, Inc. (Broadcasting & Cable)	Loans	306	306
Elexis Beta GmbH(3) (Industrial Products)	Options	426	526
Eparfin S.A.(3) (Consumer Products)	Loan	29	29
E-Talk Corporation (Business Services)	Debt Securities	8,852	6,509
	Warrants	1,157	—
Ex Terra Credit Recovery, Inc. (Business Services)	Preferred Stock (500 shares)	568	318
	Common Stock (2,500 shares)	—	—
	Warrants	—	—
Executive Greetings, Inc. (Business Services)	Debt Securities	15,938	15,938
	Warrants	360	360
Fairchild Industrial Products Company (Industrial Products)	Debt Securities	5,872	5,872
	Warrants	280	2,378
Galaxy American Communications, LLC (Broadcasting & Cable)	Debt Securities	48,869	39,217
	Options	—	—
	Standby Letter of Credit (\$750)	—	—

(1) Public company.

(2) Common stock, preferred stock, warrants, options and equity interests are generally nonincome producing and restricted.

(3) Non-U.S. company.

(4) Non-registered investment company.

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Private Finance Portfolio Company		December 31, 2001	
(in thousands, except number of shares)	Investment(2)	Cost	Value
Garden Ridge Corporation (Retail)	Debt Securities	\$26,948	\$26,948
	Preferred Stock (1,130 shares)	1,130	1,130
	Common Stock (471 shares)	613	613
Ginsey Industries, Inc.	Loans	5,000	5,000

(Consumer Products)	Convertible Debentures	500	500
	Warrants	—	504
Global Communications, LLC	Loan	1,990	1,990
(Business Services)	Debt Securities	14,884	14,884
	Equity Interest	11,067	11,067
	Options	1,639	1,639
Grant Broadcasting Systems II	Warrants	87	5,976
(Broadcasting & Cable)			
Grant Television II LLC	Options	492	492
(Broadcasting & Cable)			
Grotech Partners, VI, L.P.(4)	Limited Partnership Interest	1,463	1,060
(Private Equity Fund)			
The Hartz Mountain Corporation	Debt Securities	27,408	27,408
(Consumer Products)	Common Stock (200,000 shares)	2,000	2,000
	Warrants	2,613	2,613
Hotelevision, Inc.	Preferred Stock (315,100 shares)	315	315
(Broadcasting & Cable)			
Icon International, Inc.	Common Stock (37,821 shares)	1,219	1,519
(Business Services)			
Impact Innovations Group, LLC	Debt Securities	6,598	6,598
(Business Services)	Warrants	1,674	1,674
Intellirisk Management Corporation	Loans	22,334	22,334
(Business Services)			
Interline Brands, Inc.	Debt Securities	32,839	32,839
(Business Services)	Warrants	3,169	3,169
iSolve Incorporated	Preferred Stock (14,853 shares)	874	—
(Business Services)	Common Stock (13,306 shares)	14	—
Jakel, Inc.	Loan	22,291	22,291
(Industrial Products)			
JRI Industries, Inc.	Debt Securities	1,972	1,972
(Industrial Products)	Warrants	74	74
Julius Koch USA, Inc.	Debt Securities	1,066	1,066
(Industrial Products)	Warrants	259	7,000
Kirker Enterprises, Inc.	Warrants	348	3,501
(Industrial Products)	Equity Interest	4	4

(1) Public company.

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(3) Non-U.S. company.

(4) Non-registered investment company.

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Private Finance Portfolio Company (in thousands, except number of shares)		December 31, 2001	
	Investment(2)	Cost	Value
Kirkland's, Inc. (Retail)	Debt Securities	\$ 7,676	\$ 7,676
	Preferred Stock (917 shares)	412	412
	Warrants	96	96
Kyrus Corporation (Business Services)	Debt Securities	7,810	7,810
	Warrants	348	348
The Loewen Group, Inc.(1) (Consumer Services)	High-Yield Senior Secured Debt	15,150	12,440
Love Funding Corporation (Financial Services)	Preferred Stock (26,000 shares)	359	213
Matrics, Inc. (Business Services)	Preferred Stock (511,876 shares)	500	500
	Warrants	—	—
MedAssets.com, Inc. (Business Services)	Debt Securities	14,949	14,949
	Preferred Stock (260,417 shares)	2,049	2,049
	Warrants	136	136
Mid-Atlantic Venture Fund IV, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	2,475	1,586
Midview Associates, L.P. (Housing)	Warrants	—	—
Most Confiserie GmbH & Co KG(3) (Consumer Products)	Loan	933	933
MVL Group, Inc. (Business Services)	Loan	1,856	1,856
	Debt Securities	14,806	14,806
	Warrants	643	643
	Guaranty (\$1,357)	—	—
NetCare, AG(3) (Business Services)	Loan	811	811
NETtel Communications, Inc. (Telecommunications)	Debt Securities and Receivables	11,334	4,334
Northeast Broadcasting Group, L.P. (Broadcasting & Cable)	Debt Securities	310	310
Novak Biddle Venture Partners III, L.P. (4) (Private Equity Fund)	Limited Partnership Interest	330	330
Nursefinders, Inc. (Business Services)	Debt Securities	11,341	11,341
	Warrants	900	1,500
Onyx Television GmbH(3) (Broadcasting & Cable)	Preferred Units (120,000 shares)	201	201

(1) Public company.

(2) Common stock, preferred stock, warrants, options and equity interests are generally non-income producing and restricted.

(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

Private Finance Portfolio Company (in thousands, except number of shares)		December 31, 2001	
	Investment(2)	Cost	Value
Opinion Research Corporation(1) (Business Services)	Debt Securities	\$14,186	\$14,186
	Warrants	996	996
Oriental Trading Company, Inc. (Consumer Products)	Debt Securities	12,847	12,847
	Preferred Equity Interest	1,500	1,500
	Common Equity Interest	—	—
	Warrants	13	588
Outsource Partners, Inc. (Business Services)	Debt Securities	23,994	23,994
	Warrants	826	826
Pico Products, Inc. (Industrial Products)	Loan	1,406	1,406
Polaris Pool Systems, Inc. (Consumer Products)	Debt Securities	6,581	6,581
	Warrants	1,050	1,050
Powell Plant Farms, Inc. (Consumer Products)	Loan	16,993	16,993
Proeducation GmbH(3) (Education)	Loan	206	206
Prosperco Finanz Holding AG(3) (Financial Services)	Convertible Debentures	4,899	4,899
	Common Stock (1,528 shares)	956	956
	Warrants	—	—
Raytheon Aerospace, LLC (Business Services)	Debt Securities	5,051	5,051
	Equity Interest	—	—
Redox Brands, Inc. (Consumer Products)	Debt Securities	9,462	9,462
	Warrants	584	584
Schwinn Holdings Corporation (Consumer Products)	Debt Securities	10,195	1,835
Seasonal Expressions, Inc. (Consumer Products)	Preferred Stock (504 shares)	500	—
Simula, Inc.(1) (Industrial Products)	Loan	19,914	19,914
Soff-Cut Holdings, Inc. (Industrial Products)	Debt Securities	8,569	8,569
	Preferred Stock (300 shares)	300	300
	Common Stock (2,000 shares)	200	200
	Warrants	446	446
Southwest PCS, LLC (Telecommunications)	Loan	8,243	8,243
Startec Global Communications Corporation(1) (Telecommunications)	Loan	22,815	22,815
	Debt Securities	21,286	10,301
	Common Stock (258,064 shares)	3,000	—
	Warrants	—	—

(1) Public company.

(2) Common stock, preferred stock, warrants, options and equity interests are generally non-income producing and restricted.

(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

<b>Private Finance Portfolio Company</b> (in thousands, except number of shares)		<b>December 31, 2001</b>	
	<b>Investment(2)</b>	<b>Cost</b>	<b>Value</b>
SunStates Refrigerated Services, Inc. (Warehouse Facilities)	Loans Debt Securities	\$ 6,062 2,445	\$ 4,573 877
Sydran Food Services II, L.P. (Retail)	Debt Securities Equity Interests Warrants	12,973 3,909	12,973 3,909
Tubbs Snowshoe Company, LLC (Consumer Products)	Debt Securities Equity Interests Warrants	3,913 500 54	3,913 500 54
United Pet Group, Inc. (Consumer Products)	Debt Securities Warrants	4,965 15	4,965 15
Updata Venture Partners, II, L.P.(4) (Private Equity Fund)	Limited Partnership Interest	2,300	3,865
Velocita, Inc.(1) (Telecommunications)	Debt Securities Warrants	11,677 3,540	11,677 3,540
Venturehouse Group, LLC(4) (Private Equity Fund)	Equity Interest	667	398
Walker Investment Fund II, LLLP(4) (Private Equity Fund)	Limited Partnership Interest	1,000	743
Warn Industries, Inc. (Consumer Products)	Debt Securities Warrants	18,624 1,429	18,624 3,129
Williams Brothers Lumber Company (Retail)	Warrants	24	322
Wilshire Restaurant Group, Inc. (Retail)	Debt Securities Warrants	15,106 735	15,106 735
Wilton Industries, Inc. (Consumer Products)	Loan	12,000	12,000
Woodstream Corporation (Consumer Products)	Loan Debt Securities Equity Interests Warrants	572 7,631 1,700 450	572 7,631 4,547 1,203
<b>Total companies less than 5% owned</b>		<b>\$ 891,231</b>	<b>\$ 857,053</b>
<b>Total private finance (135 portfolio companies)</b>		<b>\$1,553,966</b>	<b>\$1,595,072</b>

(1) Public company.

(2) Common stock, preferred stock, warrants, options and equity interests are generally non-income producing and restricted.

(3) Non-U.S. company.

(4) Non-registered investment company.

The accompanying notes are an integral part of these consolidated financial statements.

(in thousands, except number of loans)	Stated Interest	Face	December 31, 2001	
			Cost	Value
Commercial Real Estate Finance				
Commercial Mortgage-Backed Securities				
CMBS Bonds				
Mortgage Capital Funding, Series 1998-MC3	5.5%	\$ 54,491	\$ 26,888	\$ 26,888
Morgan Stanley Capital I, Series 1999-RM1	6.4%	51,046	21,462	21,462
COMM 1999-1	5.6%	74,879	35,636	35,636
Morgan Stanley Capital I, Series 1999-FNV1	6.1%	45,527	22,272	22,272
DLJ Commercial Mortgage Trust 1999-CG2	6.1%	96,432	44,732	44,732
Commercial Mortgage Acceptance Corp., Series 1999-C1	6.8%	34,856	16,304	16,304
LB Commercial Mortgage Trust, Series 1999-C2	6.7%	29,005	11,326	11,326
Chase Commercial Mortgage Securities Corp., Series 1999-2	6.5%	43,046	20,535	20,535
FUNB CMT, Series 1999-C4	6.5%	49,287	22,253	22,253
Heller Financial, HFCMC Series 2000 PH-1	6.8%	45,456	18,657	18,657
SBMS VII, Inc., Series 2000-NL1	7.2%	24,230	13,309	13,309
DLJ Commercial Mortgage Trust, Series 2000-CF1	7.0%	40,502	19,481	19,481
Deutsche Bank Alex. Brown, Series Comm 2000-C1	6.9%	41,084	19,418	19,418
LB-UBS Commercial Mortgage Trust, Series 2000-C4	6.9%	31,471	11,455	11,455
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CK1	5.9%	58,786	29,050	29,050
JP Morgan-CIBC-Deutsche 2001	5.8%	60,889	29,584	29,584
Lehman Brothers-UBS Warburg 2001-C4	6.4%	65,130	32,326	32,326
SBMS VII, Inc., Series 2001-C1	6.1%	54,780	25,267	25,267
GE Capital Commercial Mortgage Securities Corp., Series 2001-2	6.1%	57,039	28,103	28,103
Credit Suisse First Boston Mortgage Securities Corp., Series 2001-CKN5	5.2%	84,482	46,176	46,176
JP Morgan Chase Commercial Mortgage Securities Corp., Series 2001-C1	5.6%	55,432	24,075	24,075
SBMS VII, Inc., Series 2001-C2	6.2%	72,422	40,037	40,037
Total CMBS bonds		1,170,272	558,346	558,346
Collateralized Debt Obligations				
Crest 2001-1, Ltd.(3)		24,207	24,207	24,207
Total CMBS		\$1,194,479	\$582,553	\$582,553

	Interest Rate Ranges	Number of Loans	Cost	Value
<b>Commercial Mortgage Loans</b>				
	Up to 6.99%	7	\$ 3,404	\$ 5,100
	7.00%- 8.99%	30	34,583	36,589
	9.00%-10.99%	16	13,617	13,618
	11.00%-12.99%	14	11,977	11,979
	13.00%-14.99%	7	12,455	12,251
	15.00% and above	2	84	60
Total commercial mortgage loans		76	\$ 76,120	\$ 79,597
Residual Interest			\$ 70,179	\$ 69,879
Real Estate Owned			3,784	2,489
Total commercial real estate finance			\$ 732,636	\$ 734,518
Total portfolio			\$2,286,602	\$2,329,590

(3) Non-U.S. company.

The accompanying notes are an integral part of these consolidated financial statements.

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## **ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Information at June 30, 2002 and 2001 and for the three and six months ended June 30, 2002 and 2001 is unaudited)**

#### **Note 1. Organization**

Allied Capital Corporation, a Maryland corporation, is a closed-end management investment company that has elected to be regulated as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"). Allied Capital Corporation ("ACC") has a subsidiary that has also elected to be regulated as a BDC, Allied Investment Corporation ("Allied Investment"), which is licensed under the Small Business Investment Act of 1958 as a Small Business Investment Company ("SBIC"). In addition, ACC has a real estate investment trust subsidiary, Allied Capital REIT, Inc. ("Allied REIT"), and several subsidiaries which are single-member limited liability companies established primarily to hold real estate properties. In April 2001, ACC established a subsidiary, A.C. Corporation ("AC Corp"), which provides diligence and structuring services on private finance and commercial real estate transactions, as well as structuring, transaction, management and advisory services to the Company, its portfolio companies and other third parties.

Allied Capital Corporation and its subsidiaries, collectively, are hereinafter referred to as the "Company."

In accordance with specific rules prescribed for investment companies, subsidiaries hold investments on behalf of the Company or provide substantial services to the Company. Portfolio investments are held for purposes of deriving investment income and future capital gains. The Company consolidates the results of its subsidiaries for financial reporting purposes. The financial results of the Company's portfolio investments are not consolidated in the Company's financial statements.

The investment objective of the Company is to achieve current income and capital gains. In order to achieve this objective, the Company invests primarily in private companies in a variety of industries and non-investment grade commercial mortgage-backed securities ("CMBS").

#### **Note 2. Summary of Significant Accounting Policies**

##### ***Basis of Presentation***

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain

reclassifications have been made to the 2001 balances to conform with the 2002 financial statement presentation.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. Accordingly, the interim financial information does not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the unaudited consolidated financial statements of the Company included herein contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of the Company as of June 30, 2002 and December 31, 2001 and the results of operations for the three and six months ended June 30, 2002 and 2001, and changes in net assets and cash flows for the six months ended June 30, 2002 and 2001. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the operating results to be expected for the full year.

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### **Note 2. Summary of Significant Accounting Policies, continued**

The private finance portfolio is presented in three categories — companies more than 25% owned which represent portfolio companies where the Company directly or indirectly owns more than 25% of the outstanding voting securities of such portfolio company and, therefore, are deemed controlled by the Company under the 1940 Act; companies owned 5% to 25% which represent portfolio companies where the Company directly or indirectly owns 5% to 25% of the outstanding voting securities of such portfolio company or where the Company holds one or more seats on the portfolio company's board of directors and, therefore, are deemed to be an affiliated person under the 1940 Act; and companies less than 5% owned which represent portfolio companies where the Company directly or indirectly owns less than 5% of the outstanding voting securities of such portfolio company and where the Company has no other affiliations with such portfolio company. The interest and related portfolio income and net realized gains or losses from the commercial real estate finance portfolio and other sources are included in the companies less than 5% owned category on the consolidated statement of operations.

#### ***Valuation of Portfolio Investments***

The Company, as a BDC, invests primarily in illiquid securities including debt and equity securities of private companies and non-investment grade CMBS. The Company's investments are generally subject to restrictions on resale and generally have no established trading market. The Company values substantially all of its investments at fair value as determined in good faith by the board of directors in accordance with the Company's valuation policy. The Company determines fair value to be the amount for which an investment could be exchanged in an orderly disposition over a reasonable period of time between willing parties other than in a forced or liquidation sale.

The Company's valuation policy considers the fact that no ready market exists for substantially all of the securities in which it invests. The Company's valuation policy is intended to provide a consistent basis for establishing the fair value of the portfolio. The Company will record unrealized depreciation on investments when it believes that an investment has become impaired, including where collection of a loan or realization of an equity security is doubtful. Conversely, the Company will record unrealized appreciation if it believes that the underlying portfolio company has appreciated in value and the Company's equity security has also appreciated in value, where appropriate. The value of investments in public securities are determined using quoted market prices discounted for restrictions on resale.

### ***Loans and Debt Securities***

For loans and debt securities, fair value generally approximates cost unless the borrower's enterprise value or overall financial condition or other factors lead to a determination of fair value at a different amount.

When the Company receives nominal cost warrants or free equity securities ("nominal cost equity"), the Company allocates its cost basis in its investment between its debt securities and its nominal cost equity at the time of origination. At that time, the original issue discount basis of the nominal cost equity is recorded by increasing the cost basis in the equity and decreasing the cost basis in the related debt securities.

Interest income is recorded on an accrual basis to the extent that such amounts are expected to be collected. For loans and debt securities with contractual payment-in-kind interest, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity,

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## **ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

#### **Note 2. Summary of Significant Accounting Policies, continued**

the Company will not accrue payment-in-kind interest if the portfolio company valuation indicates that the payment-in-kind interest is not collectible. Loans classified as Grade 4 or Grade 5 assets do not accrue interest. Loan origination fees, original issue discount and market discount are capitalized and then amortized into interest income using the effective interest method. Prepayment premiums are recorded on loans when received.

The weighted average yield on loans and debt securities is computed as the (a) annual stated interest rate earned plus the annual amortization of loan origination fees, original issue discount and market discount earned on accruing loans and debt securities, divided by (b) total loans and debt securities at value. The weighted average yield is computed as of the balance sheet date.

### ***Equity Securities***

The Company's equity interests in portfolio companies for which there is no liquid public market are valued at fair value based on the enterprise value of the portfolio company, which is determined using various factors, including cash flow from operations of the portfolio company and other pertinent factors such as recent offers to purchase a portfolio company's securities or other liquidation events. The determined fair values are generally discounted to account for restrictions on resale and minority control positions.

The value of the Company's equity interests in public companies for which market quotations are readily available is based upon the closing public market price on the balance sheet date. Securities that carry certain restrictions on sale are typically valued at a discount from the public market value of the security.

Dividend income is recorded on cumulative preferred equity securities on an accrual basis to the extent that such amounts are expected to be collected, and on common equity securities on the record date for private companies or on the ex-dividend date for publicly traded companies.

### ***Commercial Mortgage-Backed Securities ("CMBS")***

CMBS are carried at fair value, which is based upon a discounted cash flow model that utilizes prepayment and loss assumptions based upon historical experience and projected performance, economic factors and the characteristics of the underlying cash flow. The Company's assumption with regard to discount rate is based upon the yield of comparable securities. The Company recognizes income from the amortization of original issue discount using the effective interest method, using the anticipated yield over the projected life of the investment. Yields are revised when there are changes in estimates of future credit losses, actual losses incurred, or actual and estimated prepayment speeds. Changes in estimated yield are recognized as an adjustment to the estimated yield over the remaining life of the CMBS from the date the estimated yield is changed. The Company recognizes unrealized appreciation or depreciation on its CMBS, as comparable yields in the market change and/or whenever it determines that the value of its CMBS is less than the cost basis due to impairment in the underlying collateral pool.

### ***Residual Interest***

The Company values its residual interest from a previous securitization and recognizes income using the same accounting policies used for the CMBS. The residual interest is carried at fair value based on discounted estimated future cash flows. The Company recognizes income from the residual

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## **ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**



**Note 2. Summary of Significant Accounting Policies, continued**

interest using the effective interest method. At each reporting date, the effective yield is recalculated and used to recognize income until the next reporting date.

***Net Realized and Unrealized Gains or Losses***

Realized gains or losses are measured by the difference between the net proceeds from the sale and the cost basis of the investment without regard to unrealized gains or losses previously recognized, and include investments charged off during the year, net of recoveries. Unrealized gains or losses reflect the change in portfolio investment values during the reporting period.

***Fee Income***

Fee income includes fees for diligence, structuring, transaction services, management services and investment advisory services rendered by the Company to portfolio companies and other third parties. Diligence, structuring and transaction services fees are generally recognized as income when services are rendered or when the related transactions are completed. Management and investment advisory services fees are generally recognized as income as the services are rendered.

***Deferred Financing Costs***

Financing costs are based on actual costs incurred in obtaining debt financing and are deferred and amortized as part of interest expense over the term of the related debt instrument.

***Derivative Financial Instruments***

The Company may or may not use derivative financial instruments to reduce interest rate risk. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. The Company does not hold or issue derivative financial instruments for trading purposes. All derivative financial instruments are recorded at fair value with changes in value reflected in net unrealized gains or losses during the reporting period.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash in banks and all highly liquid investments with original maturities of three months or less.

***Dividends to Shareholders***

Dividends to shareholders are recorded on the record date.

***Stock Compensation Plans***

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations to account for its stock compensation plans. Under this method, the

Company records compensation expense for awards of stock options to employees only if the market price of the stock on the grant date exceeds the amount the employee is required to pay to acquire the stock.

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## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### Note 2. Summary of Significant Accounting Policies, continued

##### *Federal and State Income Taxes*

The Company intends to comply with the requirements of the Internal Revenue Code ("Code") that are applicable to regulated investment companies ("RIC") and real estate investment trusts ("REIT"). The Company and its subsidiaries that qualify as a RIC or a REIT intend to annually distribute or retain through a deemed distribution all of their taxable income to shareholders; therefore, the Company has made no provision for income taxes for these entities. AC Corp is a corporation subject to federal and state income taxes and records a provision for income taxes as appropriate.

##### *Per Share Information*

Basic earnings per share is calculated using the weighted average number of shares outstanding for the period presented. Diluted earnings per share reflects the potential dilution that could occur if options to issue common stock were exercised into common stock. Earnings per share is computed after subtracting dividends on preferred shares.

##### *Use of Estimates in the Preparation of Financial Statements*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

The consolidated financial statements include investments at value of \$2,380,969,000 and \$2,329,590,000 as of June 30 2002 and December 31, 2001, respectively, (93% and 95%, respectively, of total assets). Substantially all of these investments represent investments whose fair values have been determined by the board of directors in good faith in the absence of readily ascertainable market values. Because of the inherent uncertainty of valuation, the board of directors' estimated values may differ significantly from the values that would have been used had a ready market existed for the investments, and the differences could be material.

#### Note 3. Portfolio

**Private Finance**

At June 30, 2002 and December 31, 2001, the private finance portfolio consisted of the following:

	2002			2001		
	Cost	Value	Yield	Cost	Value	Yield
(\$ in thousands)						
Loans and debt securities	\$1,183,308	\$1,050,752	13.9%	\$1,169,673	\$1,107,890	14.8%
Equity interests	397,704	584,507		384,293	487,182	
Total	<u>\$1,581,012</u>	<u>\$1,635,259</u>		<u>\$1,553,966</u>	<u>\$1,595,072</u>	

Private finance investment activity principally involves providing financing through privately negotiated long-term debt and equity investments. Private finance investments are generally structured as loans and debt securities that carry a relatively high fixed rate of interest, which may be combined with equity features, such as conversion privileges, or warrants or options to purchase a portion of the portfolio company's equity at a pre-determined strike price, which is generally a nominal price for warrants or options in a private company. Private finance investments are generally issued by

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**ALLIED CAPITAL CORPORATION AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**
**Note 3. Portfolio, continued**

privately-owned companies and are generally illiquid and subject to restrictions on resale or transferability.

Loans and debt securities generally have a maturity of five to ten years, with interest-only payments in the early years and payments of both principal and interest in the later years, although debt maturities and principal amortization schedules vary. At June 30, 2002 and December 31, 2001, approximately 97% and 98%, respectively, of the Company's private finance loan portfolio was composed of fixed interest rate loans.

Equity interests consist primarily of securities issued by privately-owned companies and may be subject to restrictions on their resale or may be otherwise illiquid. Equity securities generally do not produce a current return, but are held in anticipation of investment appreciation and ultimate gain on sale.

At June 30, 2002 and December 31, 2001, the Company had an investment at value totaling \$251,920,000 and \$227,449,000, respectively, in Business Loan Express, Inc. ("BLX"), a small

business lender that participates in the SBA Section 7(a) Guaranteed Loan Program. The Company owns 94.9% of BLX's common stock. As the controlling shareholder of BLX, the Company has provided an unconditional guaranty to the BLX credit facility lenders in an amount up to 50% of the total obligations (consisting of principal, accrued interest and other fees) on BLX's 3-year unsecured revolving credit facility for \$124,000,000. The amount guaranteed by the Company at June 30, 2002 was \$48,100,000. This guaranty can be called by the lenders only in the event of a default by BLX. BLX was in compliance with the terms of its credit facility at June 30, 2002. In consideration for providing this guaranty, BLX will pay the Company an annual guaranty fee of approximately \$3,100,000 in 2002. BLX is headquartered in New York, NY. The Company has also provided two standby letters of credit in connection with two term securitization transactions completed by BLX in the second quarter of 2002 totaling \$10,550,000.

At June 30, 2002 and December 31, 2001, the Company had an investment in The Hillman Companies, Inc. (formerly SunSource, Inc.) totaling \$131,012,000 and \$97,227,000 at value, respectively. The Company owns 93.2% of Hillman's common stock. Hillman is a leading manufacturer of key making equipment and distributor of key blanks, fasteners, signage and other small hardware components and operates in multiple channels of the retail marketplace such as hardware stores, national and regional home centers and mass merchants. Hillman's primary operations are located in Cincinnati, Ohio.

At June 30, 2002 and December 31, 2001, the Company had an investment in WyoTech Acquisition Corporation at value totaling \$77,008,000 and \$60,388,000, respectively. The Company owned 91.35% of WyoTech's common stock. WyoTech is a proprietary trade school and its primary operations are in Laramie, Wyoming. WyoTech was sold on July 1, 2002. See Note 13 for the subsequent event.

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### Note 3. Portfolio, continued

At June 30, 2002 and December 31, 2001, Grade 4 and 5 loans and debt securities that were not accruing interest at value were as follows:

	2002	2001
(in thousands)		
Companies more than 25% owned	\$ 721	\$ 930
Companies 5% to 25% owned	899	2,848
Companies less than 5% owned	103,562	89,966
	<u>\$105,182</u>	<u>\$93,744</u>

Included in Grade 4 and 5 loans and debt securities not accruing interest were assets valued at

\$8.9 million at June 30, 2002 and December 31, 2001 that represented receivables related to companies in liquidation. In addition to Grade 4 and 5 assets that are in workout, we may not accrue interest on loans to companies that are more than 50% owned by the Company if such companies are in need of additional capital and, therefore, the Company may defer current debt service. Loans and debt securities to such companies totaled \$61,331,000 at value at June 30, 2002.

The industry and geographic compositions of the private finance portfolio at value at June 30, 2002 and December 31, 2001 were as follows:

	2002	2001
<b>Industry</b>		
Consumer products	30%	28%
Business services	24	22
Financial services	16	15
Industrial products	10	10
Retail	5	5
Education	5	5
Telecommunications	3	4
Broadcasting & cable	2	4
Other	5	7
Total	100%	100%
<b>Geographic Region</b>		
Mid-Atlantic	42%	43%
West	20	19
Midwest	17	17
Southeast	14	14
Northeast	6	5
International	1	2
Total	100%	100%

## ALLIED CAPITAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### Note 3. Portfolio, continued

##### *Commercial Real Estate Finance*

At June 30, 2002 and December 31, 2001, the commercial real estate finance portfolio consisted of the following:

(\$ in thousands)	2002			2001		
	Cost	Value	Yield	Cost	Value	Yield
CMBS	\$589,558	\$613,423	14.8%	\$582,553	\$582,553	14.8%
Loans	61,890	62,001	7.9%	76,120	79,597	7.7%
Residual interest	69,341	69,042	9.3%	70,179	69,879	9.4%
Real estate owned	3,451	1,244		3,784	2,489	
Total	<u>\$724,240</u>	<u>\$745,710</u>		<u>\$732,636</u>	<u>\$734,518</u>	

**CMBS**

At June 30, 2002 and December 31, 2001, the CMBS portfolio consisted of the following:

(in thousands)	2002			2001		
	Cost	Value	Yield	Cost	Value	Yield
CMBS bonds	\$537,025	\$560,890	14.6%	\$558,346	\$558,346	14.7%
Collateralized debt obligations	52,533	52,533	17.2%	24,207	24,207	16.9%
Total	<u>\$589,558</u>	<u>\$613,423</u>		<u>\$582,553</u>	<u>\$582,553</u>	

**CMBS Bonds.** At June 30, 2002 and December 31, 2001, the CMBS bonds, which were purchased from the original issuer, consisted of the following:

(\$ in thousands)	2002	2001
Face	\$1,181,989	\$1,170,272
Original issue discount	(644,964)	(611,926)
Cost	<u>\$ 537,025</u>	<u>\$ 558,346</u>
Value	<u>\$ 560,890</u>	<u>\$ 558,346</u>
Yield	14.6%	14.7%

The non-investment grade and unrated tranches of the CMBS bonds in which the Company invests are junior in priority for payment of interest and principal to the more senior tranches of the related CMBS bond issuance. Cash flow from the underlying mortgages generally is allocated first to the senior tranches, with the most senior tranches having a priority right to the cash flow. Then, any remaining cash flow is allocated, generally, among the other tranches in order of their relative seniority. To the extent there are defaults and unrecoverable losses on the underlying mortgages resulting in reduced cash flows, the Company's most subordinate tranche will bear this loss first. At June 30, 2002, the Company's CMBS bonds were subordinate to 92% to 97% of the tranches of bonds issued in various CMBS transactions. Given that the non-investment grade CMBS bonds in which the Company invests are junior in priority for payment of principal, the Company invests in these CMBS bonds at an approximate discount of 50% from the face amount of the bonds.